

The amazing phenomenon of ICOs

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Initial Coin Offerings, or ICOs, constitute a new financing method for start-ups specialising in blockchain technology. It consists in the sale to investors of a percentage of their own cryptographic tokens - digital equivalents to tokens or vouchers in the physical world - issued by the company, normally in exchange for cryptocurrencies such as bitcoin or ether. Upon completion of the offer period, the company uses the funds collected through the ICO to develop its project.

Shortly after a successful issue, the new token generally starts trading on different cryptocurrency exchanges, where a secondary market of cryptographic tokens has emerged that has even led to the coining of the term “tokenomics”.

For these types of companies, it represents a quick and easy method of raising capital without the need for intermediaries, unlike financing through venture capital, business angels, financial institutions, IPOs or even crowdfunding.

ICOs have been attracting enormous interest in recent months, because they have burst suddenly onto the investment asset landscape, surprising the financial industry and its regulators and supervisors, who have looked on in amazement as this unregulated activity has undergone a growth in global investment volume of 3400% between the first and third quarter of 2017. Dozens of new ICOs are launched every month, and some of them have raised hundreds of millions of dollars in a matter of hours. In fact, in the third quarter, financing through ICOs for blockchain companies has been five times greater than conventional financing.

Why are investors so interested? Firstly, the tokens are sold to a global crowd, it is not necessary to be an accredited investor or to live in a specific geographical area. Secondly, although some basic knowledge of the use of cryptocurrencies is needed because the investor has to have a wallet with bitcoins or ethers in order to buy - and in which to store - the tokens, the investment mechanism is simple and swift, without intermediation. Thirdly, it allows the enthusiasts of these technologies to support projects that they consider potentially disruptive, while for those who simply seek returns on their investment, the secondary market in tokens, with its huge price volatility, generates expectations of big profits - and the risk of heavy losses - in a matter of hours.

There are tokens of different types. Most are necessary in order to use the product or service that the company is going to develop, but do not grant ownership rights or stakes in the future profits of the company. They are called “utility tokens” and the logic behind the investment is that, if the product or service is successful, the value of the token will increase because it provides access to the service. Other tokens grant property and/or profit sharing rights, which is why they are called “security tokens”. Lastly, so-called “currency tokens” are used as mere currencies or assets, and investors pursue purely speculative aims based on price fluctuations.

It is precisely the lack of regulation, fundamentally with regard to investor protection, which has caused

concern among the authorities. Investment in ICOs inherently involves a high level of risk, as it is a commitment to projects that may or may not be developed in the end and which, even if they are, may not be successful. This means that the price volatility is enormous. In addition, in some cases this mechanism has been used to mask Ponzi schemes and other scams.

Regulators around the world have reacted in various ways, either by banning ICOs (China and South Korea), or issuing warnings and/or guidelines for issuers and investors (USA, United Kingdom, Germany, Singapore, Australia, Switzerland, Spain and the EU, through the markets authority ESMA), or by initiating the development of specific regulations (France). In general, all of them remind the tokens issuers of the regulations with which they are required to comply, depending on whether the tokens issued are considered “securities” or are more like a form of crowdfunding, and alert investors to the high level of risk associated with these instruments.

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